Suncor (TSX:SU) Stock Rally: Are Investors Too Optimistic?

Description

The share price of **Suncor Energy** (TSX:SU)(NYSE:SU) is up 60% since bottoming out near $15 in March. Investors who missed the bounce are wondering if this is a good time to buy the stock.

Oil price

The price of oil is steadily moving higher after a brutal plunge that saw WTI futures contracts briefly trade negative last month.

The drop in demand caused by pandemic lockdowns is as high as 30% according to some estimates. This happened at the same time that Saudi Arabia and Russia decided to end a pact to manage supply. The ensuing price war saw the two countries open up the taps, adding to the oversupply in the market.

At one point, analysts feared the world would run out of storage capacity as early as the end of May.

After oil plunged to levels nobody expected, Saudi-led OPEC and Russia agreed to cut nearly 10 million barrels per day from the market beginning May 1. The move, in addition to reduced production by struggling oil companies, is combining with a slow rebound in global demand to prop up prices.

WTI oil now trades above US$30 per barrel. That's still below the breakeven price for many oil producers, but high enough to slow cash burn and keep more companies alive until the global economy picks up momentum.

Suncor

Suncor is Canada's largest integrated energy company. The business is best known for the oil sands operations, but Suncor also has four large refineries that turn crude oil into things like gasoline, jet fuel, diesel fuel, and asphalt. Suncor's retail group includes about 1,500 Petro-Canada service stations.

The drop in air travel and lockdown keeping commuters at home are hitting demand for the fuel products. As a result, the downstream businesses that normally provide a nice revenue hedge for Suncor when oil prices fall are not much help in the current environment.

Suncor reported an operating loss of $309 million in Q1 2020 versus operating earnings of $1.2 billion in Q1 2019. Funds from operations came in at $1 billion compared to $2.6 billion in the same period last year.

The company has taken measures to beef up the balance sheet in preparation for a challenging few months. Suncor added $2.8 billion to its existing credit facilities and issued $1.25 billion in new notes. As of March 31, Suncor had liquidity of about $8.1 billion.

The company has also reduced the initial 2020 capital program by about 33% to $3.6 billion. In addition, the board put the share-buyback program on hold and decided to cut the quarterly dividend to $0.21 per share from $0.465 per share.

The distribution cut hurts income investors who thought Suncor would maintain the payout through the crisis. At the current share price, the reduced dividend provides a 3.5% yield.

Is Suncor a buy?

Income investors should probably search for other opportunities in the market today.

Contrarian investors with an eye on big capital gains, however, might want to start nibbling on any new weakness. The storage capacity threat appears to be fading, and the re-opening of economies around the world should drive a recovery in fuel demand.

Suncor has the financial firepower to make strategic acquisitions, and the company might add new resources at cheap prices in the coming months, as it did during the last oil rout.

Risks remain and investors should anticipate more volatility, especially heading into the U.S. election later this year. That said, global economic growth could be robust through the end of 2021 and into 2022. Suncor traded at $45 in January, so there is decent upside potential for patient investors.

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